CANADA

The Department of State submitted this report to the Senate Committees on Foreign Relations and on Finance and to the House Committees on Foreign Affairs and on Ways and Means, on January 31, 1999.

Key Economic Indicators

(Billions of U.S. Dollars unless otherwise indicated)

	1996	1997	1998 1/
Income, Production, and Employment:			
Nominal GDP 2/	601.6	617.6	600.9
Real Growth Rate (pct)	1.2	3.8	2.7
GDP by Sector (pct):			
Goods	34	33	34
Services	66	67	66
Agriculture	2	2	2
Government	24	23	20
Per Capita GDP (US$)	20,875	20,495	19,077
Total Labor Force (000s)	15,149	15,346	15,601
Unemployment Rate (pct)	9.7	9.2	8.4
Money and Prices (annual percentage growth):			
Money Supply Growth (M2) 3/	2.2	-1.5	-0.9
Consumer Price Inflation	1.6	1.6	1.0
Exchange Rate: (C$/US$) 4/	1.3635	1.3844	1.4706
Balance of Payments and Trade:			
Global Merchandise Exports	205.1	217.5	212.2
Exports to U.S.	158.7	171.8	169.5
Global Merchandise Imports	174.4	200.0	200.0
Imports from U.S.	134.5	152.0	152.0
Global Merchandise Trade Balance	30.7	17.5	12.2
Balance with U.S.	24.2	19.0	17.5
Current Account Balance/GDP (pct)	0.5	1.5	2.1
Net Public Debt 5/	427.7	421.2	396.0
Debt Service/GDP (pct) 5/	5.5	4.9	4.9
Federal Budget Deficit/GDP (pct)	1.0	0.4	0.0
Official Int'l Reserves 3/	20.6	17.9	20.1
Aid from U.S.	0	0	0
Aid from All Other Sources	0	0	0

1/ 1998 data is embassy projection unless otherwise noted.
2/ Exchange rate conversion causes nominal C$ growth to be reflected as negative US$ growth.
3/ Actual as of October 31, 1998.
4/ January to October 1998 average.
5/ Canadian Government data.

1. General Policy Framework

Canada has an affluent, high-tech industrial economy that resembles the United States in its per capita output, market-oriented economic system, and pattern of production. While production and services are predominantly privately owned and operated, the federal and provincial governments provide a broad regulatory framework and redistribute incomes among individuals and provinces. Federal government economic policies since the mid-1980s have emphasized the reduction of public sector intervention in the economy and the promotion of private sector initiative and competition. Nevertheless, government regulatory regimes affect foreign investment, most notably U.S. firms operating in telecommunications, broadcasting, publishing, energy, mining and financial services.

In 1997, the Canadian economy grew by 3.8 percent, with growth fueled by domestic demand. By the second quarter of 1998, annualized growth had slowed to 1.6 percent; consumer spending remained strong, but production cutbacks caused inventory accumulation to drop sharply, while business investment and external demand weakened. The outlook for Canada in 1998 and 1999 has been revised down to 2.7 percent and 1.9 percent, respectively, largely because of the global impact of Asia's financial problems. In the fall of 1998, the Bank of Canada followed the Fed and cut short-term interest rates to help mitigate the negative impact of the global slowdown. Nevertheless, global economic conditions are expected to erode Canadian corporate profits, which will hinder business investment, employment growth, further reductions in Canada's average unemployment rate of 8.4 percent, as well as consumer spending.

In the first ten months of 1998, the Canadian Dollar averaged 68 U.S. Cents compared to 72.60 U.S. Cents for the same period in 1997. Low interest rate yields, a sharp decline in commodity prices and Asian economic problems have caused large purchases of U.S. Dollars and a sell-off in Canadian Dollar-denominated investments. Canada's inflation rate is at the lower end of the Bank of Canada's 1-3 percent target band, and is expected to remain there in 1998 and 1999 despite the negative impact the lower Canadian Dollar will have on import prices. Global disinflationary pressures, slackening domestic labor markets, and weakening economies are primary influences.

Canada continues to be the United States' foremost export market and single largest trading and investment partner. In 1997, total two-way trade in goods and services was approximately US$365 billion, or US$1 billion per day, comprising 80 percent of Canada's total global trade. The U.S. recorded a merchandise trade deficit with Canada in 1997 of US$19 billion. However, this was partly offset by a non-merchandise trade surplus, which should continue because there is a large stock of U.S. foreign direct investment in Canada that results in high dividend payments by Canadian subsidiaries to their U.S. parents. In addition, much of Canada's external debt is held by U.S. residents, giving rise to an outward flow of debt service payments to the United States.

The United States and Canada bilateral civil aviation market is the largest in the world. As a result of the 1995 U.S.-Canada Air Transport Agreement, U.S. and Canadian airlines now are free to decide routes, ticket prices, and flight frequencies without government interference. Over a three-year period, the new agreement essentially removed all restrictions on U.S.-Canada transborder air services. By all accounts, the economic benefits of this new agreement have been enormous. Since the agreement was signed, total U.S.-Canada passenger traffic has increased by 37 percent from 12.1 million passengers in 1994 to 16.6 million passengers in 1997. Fares have decreased significantly and over forty new city-pairs have received first time service. Work on outstanding civil aviation issues has continued. Negotiators eliminated restrictions on third country code-sharing in November 1997. U.S. and Canadian officials met in November 1998 to consider issues such as co-terminalizing all cargo courier services and opening fifth freedom or beyond rights. Canadian airport user charges were also discussed.

The U.S. and Canada share a 5,500-mile border. In 1995, President Clinton and Prime Minister Chretien announced the "Accord on Our Shared Border"(aka the Shared Border Accord). The agreement is a framework for better border management that calls for the development of creative new approaches to the border (such as shared inspection facilities), and seeks an appropriate balance between commercial facilitation and law enforcement. A key goal of the Shared Border Accord is to move from "parallel, but separate" approaches to much closer cooperation and common efforts. Officials from both countries are working to reassess the original priorities of the Shared Border Accord and develop new initiatives.

2. Exchange Rate Policy

The Canadian Dollar is a fully convertible currency, and exchange rates are determined by supply and demand conditions in the exchange market. There are no exchange control requirements imposed on export receipts, capital receipts, or payments by residents or non-residents. The Bank of Canada, which is the country's central bank, operates in the exchange market on almost a daily basis to try to maintain orderly trading conditions.

3. Structural Policies

Prices for most goods and services are established by the market. The most important exceptions are government services, services provided by regulated public service monopolies, most medical services, and supply-managed and other agricultural products (including wheat, eggs, poultry and dairy products). The principal sources of federal tax revenue are corporate and personal income taxes and the Goods and Services Tax (GST), a multi-stage seven percent value-added tax on consumption. The personal and corporate income tax burden, combining federal and provincial taxes and surcharges, is significantly higher than in the U.S.

4. Debt Management Policies

Canadian federal and provincial governments have made great strides in reducing their respective budget deficits in a non-inflationary environment. Canada's fiscal year runs from April 1-March 31. In FY97-98, the federal government recorded a C$3.5 billion budget surplus, the first in 28 years, which was applied to Canada's national debt, reducing it to C$579.7 billion, or 67.8 percent of GDP. At the same time, the combined deficit of Canada's ten provincial governments was cut almost in half in FY97-98, to C$3.7 billion from C$7.3 billion in FY96-97. While foreigners are receptive to holding Canadian securities, the government launched initiatives to place more of the country's debt with Canadians and reduce international obligations. In FY97-98, the federal government had no new net borrowing requirements.

5. Significant Barriers to U.S. Exports

On January 1, 1989, Canada and the United States began to implement the US-CFTA, a free trade agreement to eliminate over a 10 year period virtually all tariff and non-tariff barriers to trade between the two countries. The US-CFTA was superseded on January 1, 1994, with the inauguration of the NAFTA, which extends the US-CFTA to Mexico and expands on it in the areas of services, investment and government procurement. As of January 1, 1998, Canada eliminated all tariffs between the U.S. and Canada, except for supply-managed products (like poultry and dairy products).

However, nontariff barriers at both the federal and provincial levels continue to impede access of U.S. goods and services to Canada or retard potential export growth. Canada maintains some restrictions on foreign investment and content in the so-called "cultural industries" and related sectors, including book and magazine publishing, broadcasting, and telecommunications. The United States objects to some of these restrictions and closely monitors new laws and regulations affecting these sectors.

Various restrictions limit U.S. access to the Canadian market for magazines. In 1997, a WTO panel supported U.S. complaints against these measures, including a ban on imports of magazines with advertising directed at Canadians, a special 80 percent excise tax on split-run magazines, and discriminatory postal rates on imported magazines (the Sports Illustrated case). In October 1998, Canada tabled legislation which will have effects similar to the previous measures, by making it a criminal offense for foreign publishers to supply advertising services directed at the Canadian market. The legislation is expected to be passed when parliament reconvenes in February, 1999. The U.S. continues to oppose the legislation.

Canada is a signatory to the GATS Agreement on Basic Telecommunications Services. Recent regulatory changes have opened both long-distance and local telephone services to competition. Canada's WTO obligations require a monopoly by Teleglobe Inc. on overseas calling to end in 1999. In September 1998, Canada eliminated third country routing restrictions for international traffic routed to and from Canada through the United States. Canada's Telecommunications Act allows the federal regulator, the Canadian Radio-Television and

Telecommunications Commission, to forbear from regulating competitive segments of the industry, and exempts resellers from regulation. Canada retains a 46.7 percent limit on foreign ownership and a requirement for Canadian control of basic telecommunications facilities.

Foreign access to the Canadian financial services sector has improved as a result of the NAFTA and the GATS. The WTO Agreement Implementation Act removed long-standing limitations on non-Canadian ownership of federally regulated financial institutions; lifted a market share limitation on foreign banks; and extended NAFTA thresholds for investment review and control to all WTO members. Banking falls exclusively under federal jurisdiction, while the regulation of securities companies falls under provincial control.

The legislated five-year review of the Bank Act that took place in 1997 removed the requirement that foreign banks had to participate in the Canada Deposit Insurance Plan. In addition, the federal government has agreed to allow foreign bank branching, although legislation to bring branching into effect has been postponed. Nevertheless, Canada has a commitment to bring branching into effect by June 30, 1999 under the terms of the WTO Financial Services Agreement. In Canada's insurance market, companies can incorporate under provincial or federal law. Foreign ownership remains subject to investment review thresholds, and several provinces continue to subject foreign investments in existing, provincially incorporated companies to authorization. Insurance companies may supply their services either directly, through agents or through brokers.

Life insurance companies are not in general allowed to offer other services (except for health, accident and sickness insurance), but may be affiliated to, and distribute the products of, a property and casualty insurer. As in banking, commercial presence is required to offer insurance, reinsurance and retrocession services in Canada. However, companies may branch from abroad on condition that they maintain trustees assets equivalent to their liabilities in Canada. Insurance companies can own deposit-taking financial institutions, investment dealers, mutual fund dealers and securities firms. In addition, insurance companies may engage directly in lending activities on an equal footing with deposit-taking institutions. The car insurance industry is a publicly-owned monopoly in Quebec, British Columbia, Manitoba and Saskatchewan. All other provinces have regulated premiums.

Canada applies various restrictions to imports of supply-managed products (dairy, eggs and poultry), as well as fresh fruit and vegetables, potatoes, and processed horticultural products. The United States continues to pursue these issues bilaterally. With regard to Canada’s policies on milk, the United States maintains that Canada (1) is providing export subsidies on dairy products without regard to its export subsidy reduction commitments in the Agreement on Agriculture (see also Export Subsidies Policies section), and (2) has failed to fulfill its WTO commitment to provide access for 64,500 metric tons of fluid milk imports annually. The U.S. is addressing these issues through the WTO dispute settlement process.

Provincial legislation and Liquor Board policies regulate Canadian importation and retail distribution of alcoholic beverages. U.S. exporters object to provincial minimum import price requirements, and cost-of-service and packaging size issues hinder the importation of U.S. wine.

Canadian customs regulations limit the temporary entry of specialized equipment needed to perform short-term service contracts. Certain types of equipment are granted duty-free or reduced-duty entry into Canada only if they are unavailable from Canadian sources. Although NAFTA has broadened the range of professional equipment permitted entry, it has not provided unrestricted access.

The Canadian Special Import Measures Act (SIMA) governs the use of anti-dumping and countervailing duties. Canada operates a partially bifurcated trade remedies system under SIMA. The Deputy Minister of National Revenue is responsible for initiating investigations and making preliminary and final determinations respecting dumping/subsidizing and preliminary determinations of injury. The Canadian International Trade Tribunal (CITT) is responsible for making final injury determinations. In most cases, the SIMA investigation process, from initiation to final order, is completed within 210 days. As the result of a 1996 Parliamentary Subcommittee Review of the SIMA, the Canadian Parliament is in the process of making some modest changes to Canadian trade remedy laws. When the SIMA investigation process has resulted in levies imposed on U.S. products, these duties become an impediment to U.S. trade opportunity.

Transboundary environmental issues continue as a major border preoccupation of direct interest to U.S. citizens from Maine to Alaska. Cooperation dates back to the 1909 Boundary Waters Treaty, and has grown to include collaboration on watersheds, flooding, air pollution and other common concerns. Efficient management of this agenda is complicated because of shared federal, state/provincial and local jurisdiction, and by the fact that it is carried out not only through bilateral agreements but by unique institutions such as the International Joint Commission (IJC) and the still-evolving NAFTA Commission on Environmental Cooperation (CEC).

6. Export Subsidies Policies

Canada largely eliminated its export subsidies on western-grown wheat, barley, oats, canola and many other agricultural commodities in 1995. Export credit guarantees to support bulk and processed agricultural product exports are available through the Canadian Wheat Board and the Export Development Corporation, both crown corporations. Due to lack of transparency, data on the value and/or volume of commodities exported with credit guarantee support, destination countries, and terms are very limited.

In 1995 and 1996, Canada eliminated its producer levy-funded export subsidy program for dairy products. It then implemented a two-tiered pricing system that enables dairy product processors to acquire milk at a discount on the condition that the resulting products are exported or incorporated into certain further processed food products. By charging a higher price for milk and milk containing products for domestic consumption, the Canadian Dairy Commission is able to provide dairy product exporters with access to lower priced milk. Canada contends that by implementing these changes it has eliminated export subsidies for dairy and is in compliance with its WTO commitments on export subsidies. The United States maintains that Canada continues to provide export subsidies, and is addressing the issue through the WTO dispute settlement process.

7. Protection of U.S. Intellectual Property

Canada belongs to the World Trade Organization (WTO) and the World Intellectual Property Organization (WIPO). Canada is a signatory to the Paris Convention, Berne Convention, Rome Convention, Patent Cooperation Treaty, Strasbourg Agreement, Budapest Treaty, and the Universal Copyright Treaty. On December 18, 1997, the Canadian Government committed itself to sign the WIPO Copyright Treaty and the WIPO Performances and Phonograms Treaty, which deal with copyright and protection for performers and phonogram producers. In 1998, the U.S. Trade Representative maintained Canada on the "Special 301" Watch List because of provisions in the Canadian Copyright Act on "neighboring rights" and an audio cassette levy.

The government has long-standing legislation to protect intellectual property rights, and these laws are effectively enforced. A "Bilateral Cooperation Understanding" between the U.S. Patent and Trademark Office and the Canadian Intellectual Property Office stipulates that the respective department heads from both countries meet at least annually to consider where future joint activities, exchange of information, or other forms of cooperation are feasible and mutually beneficial.

Patents: In the late 1980s and early 1990s, Canada passed legislation to bring its patent drug regime into GATT compliance.

Copyright: The Canadian Copyright Act of 1924 was amended to reflect the state of modern technology and introduce adequate enforcement measures. The 1997 legislation includes, inter alia, "neighboring rights," which requires broadcasters to pay royalties to recording artists and record producers. The 1997 legislation also establishes a levy on recordable, blank audio media, such as cassettes and tapes. The United States has objected to the fact that "neighboring rights," which took effect January 1, 1998, and the audio cassette levy, which took effect March 12, 1998, deny benefits to U.S. producers and performers. However, neither of these Canadian actions has yet been implemented.

8. Worker Rights

a. The Right of Association: Except for members of the armed forces, workers in both the public and private sectors have the right to associate freely. These rights, protected by both the federal labor code and provincial labor legislation, are freely exercised.

b. The Right to Organize and Bargain Collectively: Workers in both the public and private sectors freely exercise their rights to organize and bargain collectively. Some essential public sector employees have limited collective bargaining rights that vary from province to province. Over 37 percent of Canada's non-agricultural workforce is unionized.

c. Prohibition of Forced or Compulsory Labor: There is no forced or compulsory labor practiced in Canada.

d. Minimum Age for Employment of Children: Generally, workers must be 17 years of age to work in an industry under federal jurisdiction. Provincial standards (covering more than 90 percent of the national workforce) vary, but generally require parental consent for workers under 16 and prohibit young workers in dangerous or nighttime work. In all jurisdictions, a person cannot be employed in a designated trade (become an apprentice) before the age of 16. The statutory school-leaving age in all provinces is 16.

e. Acceptable Conditions of Work: Federal and provincial labor codes establish labor standards governing maximum hours, minimum wages and safety standards. Those standards are respected in practice.

f. Rights in Sectors with U.S. Investment: Worker rights are the same in all sectors, including those with U.S. investment.

Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad on an Historical Cost Basis -- 1997

(Millions of U.S. Dollars)

Category		Amount
Petroleum		12,738
Total Manufacturing		45,892
Food & Kindred Products	5,227	
Chemicals & Allied Products	7,783	
Primary & Fabricated Metals	3,986	
Industrial Machinery and Equipment	2,726	
Electric & Electronic Equipment	1,127	
Transportation Equipment	12,996	
Other Manufacturing	12,047	
Wholesale Trade		7,307
Banking		1,047
Finance/Insurance/Real Estate		19,050
Services		4,667
Other Industries		9159
TOTAL ALL INDUSTRIES		99,859

Source: U.S. Department of Commerce, Bureau of Economic Analysis.